

ORIGINAL



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BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

ARIZONA CORPORATION COMMISSION
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IN THE MATTER OF THE
APPLICATION OF ARIZONA
PUBLIC SERVICE COMPANY FOR
A HEARING TO DETERMINE THE
FAIR VALUE OF THE UTILITY
PROPERTY OF THE COMPANY
FOR RATEMAKING PURPOSES,
TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO
DEVELOP SUCH RETURN, AND
FOR APPROVAL OF PURCHASED
POWER CONTRACT.

DOCKET NO. E-01345A-03-0437

NOTICE OF FILING DIRECT
TESTIMONY OF KEVIN C.
HIGGINS IN CONNECTION WITH
THE PROPOSED SETTLEMENT
AGREEMENT

Arizona Corporation Commission

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Arizonans for Electric Choice & Competition, Phelps Dodge Mining Company,
Federal Executive Agencies, and The Kroger Co. hereby provide notice of filing the
direct testimony of their witness, Kevin C. Higgins, in the above-captioned docket in
connection with the Proposed Settlement Agreement.

RESPECTFULLY SUBMITTED this 27th day September 2004.

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2 the foregoing were filed this 27th day
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3 Docket Control
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6 this 27th day of September 2004, to:

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DIRECT TESTIMONY OF KEVIN C. HIGGINS

**On Behalf of Arizonans for Electric Choice & Competition,
Phelps Dodge Mining Company, Federal Executive Agencies, and The Kroger Co.**

Docket No. E-01345A-03-0437

September 27, 2004

TABLE OF CONTENTS

| | | |
|----|---|----|
| 1 | | |
| 2 | Introduction | 1 |
| 3 | Overview and conclusions | 3 |
| 4 | Revenue requirements | 4 |
| 5 | Rate spread/EPS surcharge rate design | 6 |
| 6 | Rate design (pertaining to base rates) | 11 |
| 7 | Demand-Side Management | 17 |
| 8 | Direct access service | 18 |
| 9 | Conclusion | 19 |
| 10 | | |

1 **DIRECT TESTIMONY OF KEVIN C. HIGGINS**

2

3 **Introduction**

4 **Q. Please state your name and business address.**

5 A. Kevin C. Higgins, 39 Market Street, Suite 200, Salt Lake City, Utah,
6 84101.

7 **Q. By whom are you employed and in what capacity?**

8 A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies
9 is a private consulting firm specializing in economic and policy analysis
10 applicable to energy production, transportation, and consumption.

11 **Q. On whose behalf are you testifying in this phase of the proceeding?**

12 A. With respect to the Settlement Agreement that has been put forward to
13 resolve the issues in this proceeding, I am testifying on behalf of Arizonans for
14 Electric Choice and Competition ("AECC"), Phelps Dodge Mining Company
15 ("Phelps Dodge"), Federal Executive Agencies ("FEA"), and The Kroger Co.
16 ("Kroger"). AECC, Phelps Dodge Mining, FEA, and Kroger represent retail
17 customer interests in the General Service class. Each of these parties supports and
18 has signed the Settlement Agreement.

19 **Q. Have you previously filed testimony in this proceeding?**

20 A. Yes, I filed both direct and rebuttal testimony on behalf of AECC.

21 **Q. Please describe your professional experience and qualifications.**

22 A. My academic background is in economics, and I have completed all
23 coursework and field examinations toward the Ph.D. in Economics at the

1 University of Utah. In addition, I have served on the adjunct faculties of both the
2 University of Utah and Westminster College, where I taught undergraduate and
3 graduate courses in economics. I joined Energy Strategies in 1995, where I assist
4 private and public sector clients in the areas of energy-related economic and
5 policy analysis, including evaluation of electric and gas utility rate matters.

6 Prior to joining Energy Strategies, I held policy positions in state and local
7 government. From 1983 to 1990, I was economist, then assistant director, for the
8 Utah Energy Office, where I helped develop and implement state energy policy.
9 From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County
10 Commission, where I was responsible for development and implementation of a
11 broad spectrum of public policy at the local government level.

12 **Q. Have you previously testified before this Commission?**

13 A. Yes. I have testified in a number of proceedings before this Commission,
14 including the generic proceeding on retail electric competition (1998),¹ the
15 hearings on the APS and TEP settlement agreements implementing the Electric
16 Competition Rules (1999),² the AEPCO transition charge hearings (1999),³ the
17 Commission's Track A proceeding (2002),⁴ the APS adjustment mechanism
18 proceeding (2003),⁵ and the Arizona ISA proceeding (2003).⁶

19 **Q. Have you testified before utility regulatory commissions in other states?**

¹ Docket No. RE-00000C-94-0165.

² Docket Nos. RE-00000C-94-0165, E-01345A-98-0473, E-01933A-97-0773, E-01345A-98-0471, and E-01933A-97-0772.

³ Docket No. E-01773A-98-0470.

⁴ Docket Nos. E-00000A-02-0051; E-01345A-01-0822; E-00000A-01-0630; E-01933A-02-0069; E-01933A-98-0471.

⁵ Docket No. E-01345A-02-0403.

⁶ Docket No. E-00000A-01-0630.

1 A. Yes. I have testified numerous times on the subjects of electric utility rates
2 and industry restructuring before state utility regulators in Colorado, Georgia,
3 Idaho, Indiana, Michigan, Nevada, New York, Ohio, Oregon, South Carolina,
4 Utah, Washington, and Wyoming.

5 A more detailed description of my qualifications is contained in
6 Attachment KCH-1, attached to my direct testimony.
7

8 **Overview and conclusions**

9 **Q. What is the purpose of your testimony with respect to the Settlement**
10 **Agreement?**

11 A. I am testifying in support of the Settlement Agreement as proposed by the
12 Stipulating Parties on August 18, 2004.

13 **Q. Did you personally participate in the negotiations that led to the Settlement**
14 **Agreement?**

15 A. Yes, I participated throughout the negotiation process.

16 **Q. What is your assessment of the Settlement Agreement?**

17 A. The Settlement Agreement is a comprehensive treatment of wide-ranging,
18 complex, and interrelated issues. It was carefully crafted over a period of months
19 and represents a balancing of interests among diverse Parties who have negotiated
20 and compromised in good faith to produce a result that is in the public interest. In
21 my opinion, the Settlement Agreement, taken as a whole, produces rates, terms,
22 conditions, and policies that are just and reasonable. Because of the complex
23 tradeoffs among multiple issues and multiple parties, it is essential that the

1 Settlement Agreement be viewed as a total package. The Stipulating Parties have
2 each made concessions in reliance on the advancement of the complete
3 Agreement as negotiated. I strongly recommend adoption of the Settlement
4 Agreement in the form presented by the Parties, as any alterations to the package
5 are highly likely to deprive some Parties of the benefits of their bargains.

6 **Q. How is your testimony organized?**

7 A. My testimony is organized by the following topics:

- 8 • Revenue requirements
- 9 • Rate spread/Environmental Portfolio Standard surcharge rate design
- 10 • Rate design (pertaining to base rates)
- 11 • Demand-Side Management (DSM), and
- 12 • Direct access service.

13 **Q. Why have you combined Rate Spread and the Environmental Portfolio**
14 **Standard surcharge rate design into a single topic?**

15 A. From the standpoints of AECC, Phelps Dodge, FEA, and Kroger, the
16 Settlement Agreement's treatment of rate spread and the Environmental Portfolio
17 Standard ("EPS") surcharge rate design are closely interrelated and most
18 effectively addressed in tandem.

19
20 **Revenue requirements**

21 **Q. What are the revenue requirements features of the settlement agreement?**

22 A. Paragraph 1 of the Settlement Agreement provides that APS will receive a
23 rate increase of \$75.5 million, of which \$67.5 million is in base rates and \$8

1 million is in the Competition Rules Compliance Charge ("CRCC"). This
2 translates into an average base rate increase of 3.77 percent, plus .44 percent for
3 the CRCC.

4 **Q. How do the revenue requirements in the Settlement Agreement compare**
5 **with the initial request by APS in its application?**

6 A. In its Application, APS requested an overall rate increase of \$175 million,
7 or 9.75 percent. Of this amount, \$167 million was in base rates, and \$8 million
8 was in the CRCC. In addition, in rebuttal testimony, APS revised its base revenue
9 requirement upward by an additional 1 percent to \$185 million, although the
10 Company did not seek to recover this additional amount in rates.

11 The Settlement Agreement reduces the initial overall increase requested
12 by APS by approximately 57 percent.

13 **Q. How do the revenue requirements in the Settlement Agreement compare**
14 **with the recommendations in your direct testimony?**

15 A. In my direct testimony, I recommended adjustments that reduced APS'
16 proposed increase of \$175 million by approximately \$150 million. One of these
17 adjustments – denial of the reversal of the \$234 million write-down – is explicitly
18 incorporated into the Settlement results.

19 Another adjustment I had recommended – denial of including certain
20 PWEC assets in APS rate base – was resolved through a compromise that allows
21 these units into rate base, but at a lesser value than was initially sought by APS.
22 Specifically, Paragraph 7 of the Settlement Agreement provides that PWEC assets
23 will have an original cost rate base of \$700 million. This represents a \$148

1 million disallowance from the original cost of the assets as of December 31, 2004.

2 In addition, APS has agreed to forego any present or future stranded cost claims
3 on the PWEC assets coming into rate base [Paragraph 8].

4 **Q. Should the revenue requirements elements of the Settlement Agreement be**
5 **adopted?**

6 A. Yes. The revenue requirements elements of the Settlement Agreement are
7 integral parts of a comprehensive agreement. They reflect reasonable
8 compromises that resulted from extensive negotiations among the parties. I
9 recommend that the revenue requirements be adopted as part of the entire
10 settlement package.

11
12 **Rate spread/EPS surcharge rate design**

13 **Q. What are the rate spread provisions in the Settlement Agreement?**

14 A. Section XIX of the Settlement Agreement identifies rate increases for the
15 various rate schedules. The Residential class as a whole would see a base rate
16 increase of 3.94 percent. Schedules E-32, E-32R, E-34, E-35, E-53, E-54 – which
17 are in the General Service class – and certain contracts would each experience
18 base rate increases of 3.5 percent. Schedules E-20, E-21, E-22, E-23, E-24, E-30,
19 E-38, E-38T, E-40, E-47, E-51, E-59, E-67, and E-221 would experience base rate
20 increases of 5 percent.

21 **Q. What accounts for the differences in rate increases among the various rate**
22 **schedules?**

1 A. As AECC, FEA, and Kroger discussed in their previously-filed direct
2 testimony, and as shown in APS' initial application, the APS General Service
3 class is paying rates that subsidize all of the other customer classes. It is
4 important, on the grounds of both equity and efficiency, to take steps to remove
5 such subsidies from rates, while recognizing that it may not be pragmatic to
6 eliminate all subsidies at once, due to the potential rate impact on the subsidized
7 classes. In this situation, it is appropriate for the General Service class to
8 experience a less-than-average increase, and for classes being subsidized to
9 experience a greater-than-average increase. The rate spread in the Settlement
10 Agreement takes a very modest step in the direction of reducing cross-subsidies
11 by moving rates in the direction of cost-of-service.

12 **Q. Do you believe that the rate spread in the Settlement Agreement is just and**
13 **reasonable?**

14 A. Yes, but only insofar as the rate spread is an integral component of the
15 larger Agreement. Absent other key provisions in the Settlement Agreement, the
16 Settlement rate spread would *not* be acceptable to AECC, Phelps Dodge, FEA,
17 and Kroger, as these parties otherwise view the base rate increase for General
18 Service as being too high, in light of the subsidy this class is currently paying.
19 These parties have accepted the Settlement rate spread in light of other
20 considerations in the Settlement Agreement.

21 **Q. What are examples of Settlement provisions that were essential to General**
22 **Service customers in accepting the Settlement rate spread?**

1 A. As the Settlement Agreement is a comprehensive document with many
2 interrelated considerations, I will not attempt to provide an exhaustive listing of
3 such provisions, but relevant provisions include General Service rate design as
4 well as the Environmental Portfolio Standard ("EPS") surcharge rate design.

5 **Q. Please explain the connection of the EPS surcharge rate design to the**
6 **acceptance of the Settlement rate spread by AECC, Phelps Dodge, FEA, and**
7 **Kroger.**

8 A. The EPS surcharge is currently set at \$.00875 per kWh. In addition, there
9 are monthly caps in place for three categories of customers. For residential
10 customers, the cap is \$0.35 per month. For non-residential customers with loads
11 greater than 3 MW in size, the cap is \$39 per month. For all other non-residential
12 customers, the cap is \$13 per month.

13 Section VIII of the Settlement Agreement addresses the EPS surcharge.
14 Paragraph 63 in that section states:

15 APS shall also recover costs for EPS-eligible renewables through the EPS
16 surcharge, which shall be established in this case as an adjustment
17 mechanism to allow for specific Commission-approved changes to APS'
18 EPS funding. The initial charge will be the same as contained in the
19 current EPS surcharge tariff, including caps. If the Commission amends
20 the EPS surcharge set forth in Rule 1618 or approves additional EPS
21 funding pursuant to paragraph 64 of this Agreement, *any change in EPS*
22 *funding requirements resulting from such actions shall be collected from*
23 *APS' customers in a manner that maintains the proportions between*
24 *customer categories embodied in the current EPS surcharge.* These
25 adjustments may be made outside a rate case. [Emphasis added.]
26

27 As laid out in Paragraph 63, the Settlement Agreement establishes rate
28 design parameters for the EPS surcharge. The Settlement Agreement does *not* cap
29 the total funding of the EPS program, nor does it require retention of the current

1 caps if EPS funding is increased from current levels. However, Paragraph 63 does
2 require that changes in EPS funding levels be collected in a manner that maintains
3 the proportions between customer categories embodied in the current EPS
4 surcharge. In other words, if the EPS funding is increased from current levels, the
5 most straightforward means of collecting the increased revenues consistent with
6 the Settlement would be to increase all EPS surcharge rate elements
7 proportionally – the per-kWh charge plus each category of cap.

8 Maintaining the proportionality of the current EPS surcharge among the
9 three categories of customers is a key provision of the Settlement Agreement for
10 AECC, Phelps Dodge, FEA, and Kroger. The presence of this provision in the
11 Agreement, among others, makes it possible for these General Service parties to
12 accept the Settlement Agreement's rate spread provisions, despite the level of
13 subsidy payment to the other customer classes built into General Service base
14 rates.

15 **Q. Can you provide a simple example of how this proportionality principle**
16 **would work?**

17 **A.** Yes. For example, if EPS funding requirements were to double from the
18 level collected under the current EPS surcharge, this additional funding could be
19 realized, consistent with the Settlement Agreement, by doubling the per kWh
20 charge of \$.00875, *and* doubling each of the three customer caps.

21 **Q. What type of approach to funding the EPS surcharge would violate the**
22 **Settlement Agreement?**

1 A. It would violate the Settlement Agreement to attempt to raise additional
2 EPS funds by raising one of the customer caps in a manner that altered the
3 proportions among the customer categories embodied in the current EPS
4 surcharge.

5 **Q. There is currently an open docket that is considering changes to Rule 1618,**
6 **which governs the EPS. Do you think it is appropriate to address EPS rate**
7 **design in the context of the general rate case Settlement Agreement?**

8 A. Yes, absolutely. In fact, it would be highly *inappropriate* from a rate
9 making and overall public policy standpoint to address EPS rate design outside a
10 general rate case. Issues of equitable rates among customer classes (or categories)
11 should not be decided in isolation from the breadth of facts available in a general
12 rate case. It would be wrong to set the EPS surcharge rate design in a vacuum that
13 ignored pertinent facts, such as the level of subsidies paid by APS General
14 Service customers in base rates. The proper forum for considering the full
15 spectrum of customer equity considerations is a general rate case, as opposed to a
16 single-issue docket. Accordingly, the EPS surcharge rate design is properly
17 incorporated into the comprehensive package developed in the Settlement
18 Agreement.

19 **Q. Does the Settlement Agreement restrict the Commission's ability to increase**
20 **total funding for the EPS?**

21 A. No. As I indicated above, the Settlement Agreement does not cap the total
22 funding that the Commission may make available for the EPS program.

23 **Q. Does the Settlement Agreement cap the EPS surcharge at current levels?**

1 A. If the Commission does not alter the current level of EPS funding, then the
2 Agreement retains the caps at their current levels. However, as I indicated above,
3 if the Commission *increases* the level of funding for the EPS program, then the
4 Settlement Agreement does *not* require retention of the current caps. It simply
5 requires that the *proportions* among the customer categories be retained.

6 **Q. What is your recommendation to the Commission concerning the Settlement**
7 **Agreement's treatment of rate spread and the EPS surcharge?**

8 A. These provisions of the Settlement Agreement are an integral part of the
9 comprehensive agreement. They were painstakingly crafted through intense
10 negotiations among the parties. I recommend that these provisions be adopted
11 exactly as proposed as part of the entire settlement package. Changing any aspect
12 of these provisions is certain to deny some parties the benefit of their bargains.

13
14 **Rate design (pertaining to base rates)**

15 **Q. What other aspects of rate design do you wish to address?**

16 A. I wish to address three rate design issues pertaining to base rates that are
17 incorporated into the Settlement Agreement: (1) voltage differentiation; (2)
18 unbundled rates; and (3) specific design issues pertaining to General Service
19 Schedules E-32, E-34, and E-35.

20 **Q. How is voltage differentiation treated in the Settlement Agreement?**

21 A. The Settlement Agreement provides for rates that are differentiated
22 according to the voltage at which each customer takes service. The Settlement
23 Agreement adopts the basic approach proposed by APS in its Application, with

1 some modifications. AECC, FEA, and Kroger each supported APS' general
2 approach to voltage differentiation (with selected modifications) in previously-
3 filed direct testimony.

4 Customers typically take service at one of three basic voltage levels:
5 secondary, primary, or transmission. The cost of providing service differs
6 according to voltage level; for instance, customers taking service at transmission
7 voltage do not use any of the primary and secondary components of the
8 distribution system, and so do not require the utility to make any investment in
9 these components. Yet, currently, APS' Standard Offer General Service rates do
10 not distinguish among service at differing voltage levels (although the APS'
11 Direct Access rates do make such a distinction). Failure to set different rates for
12 different voltage levels causes a subsidy within the General Service class from
13 higher-voltage customers to lower-voltage customers.

14 In my experience, I know of no utility, except APS, that does not
15 differentiate its rates across secondary, primary, and transmission service. The
16 Settlement Agreement's incorporation of this distinction in this proceeding is
17 consistent with the general approach adopted in the vast majority of utility tariffs
18 across the country.

19 **Q. What modifications were made to APS' initial proposal?**

20 A. The Settlement Agreement modifies APS' initial proposal to recognize
21 two additional facts concerning the costs on the APS system:
22 (1) Paragraph 120 recognizes that military base customers served directly from an
23 APS substation will not be charged for the cost of APS' primary line and

1 secondary distribution investments, and establishes a cost-based voltage discount
2 applicable to military base customers with this service configuration; and

3 (2) The rate design of Schedule E-32 recognizes that customers with demands of
4 100 kW and greater do not utilize APS' secondary feeders. This cost-of-service
5 consideration is recognized in the design of the E-32 demand charge in the
6 Settlement Agreement.

7 **Q. In your opinion, is the Settlement Agreement's treatment of voltage**
8 **differentiated rates just and reasonable?**

9 A. Yes, it is.

10 **Q. Turning now to rate unbundling, how does the Settlement Agreement treat**
11 **this issue?**

12 A. The Settlement Agreement adopts the basic approach to unbundling each
13 schedule's rate components that APS proposed in its Application – an approach
14 that AECC, FEA, and Kroger supported in previously-filed direct testimony.
15 Separating individual rate components by function, such as generation,
16 transmission, and distribution, is required by the Electric Competition Rules, and
17 will provide better information to customers.

18 As the Settlement Agreement rates are lower than the rates APS proposed
19 in its Application, it was necessary for the Parties to negotiate the treatment of the
20 individual unbundled rate components at the stipulated revenue requirement,
21 particularly for the rate schedules for which future direct access would be most
22 relevant. This approach is explained in Paragraph 119, which states that "with
23 regard to Schedules E-32, E-34, and E-35, the non-systems-benefits revenue

1 requirement assigned to the General Service class will be used to establish first
2 the unbundled component of generation at cost and then the unbundled
3 component of revenue cycle services at cost.” In this manner, the generation
4 component is set at a rate that is neither below nor above cost, so as not to distort
5 the economics of shopping.

6 **Q. In your opinion, is the Settlement Agreement’s treatment of unbundling rate**
7 **components just and reasonable?**

8 A. Yes. In separately stating generation and transmission cost components, it
9 will make the process of evaluating direct access opportunities more transparent
10 for customers who wish to do so. At the same time, APS’ rates will also continue
11 to be provided on a bundled basis for Standard Offer service. Customers who are
12 not interested in evaluating direct access service can choose to ignore the
13 unbundled detail in the tariff, and simply continue to focus on the bundled rates
14 on their bill.

15 **Q. Turning now to the specific General Service rate designs, do you have any**
16 **overall comments you wish to make regarding the Settlement Agreement?**

17 A. Yes. Specific rates for Schedules E-32, E-34, and E-35 are included in
18 Appendix J of the Settlement Agreement. Whereas the Settlement Agreement
19 summarizes the design objectives negotiated by the parties, it is the negotiated
20 rates themselves, as they appear in Appendix J, that constitute the ultimate basis
21 in reaching agreement for AECC, Phelps Dodge, FEA, and Kroger. Each element
22 of these rate designs was the subject of negotiation over an extended period of
23 time. The relationship between demand and energy charges, the designation of

1 rate blocks, the differentiation of rates by voltage, the demarcation of unbundled
2 components – in short, every component of the General Service rates in Appendix
3 J – is an integral part of the Settlement Agreement and was of material interest in
4 reaching settlement to at least one of the signatory Parties.

5 **Q. Are there specific aspects of the E-32 rate design that you wish to point out?**

6 A. Yes. As Paragraph 121 states, Schedule E-32 was modified in an effort to
7 simplify the design, to make it more cost-based, and to smooth out the rate impact
8 across customers of varying sizes within the rate schedule. The E-32 rate design
9 in the Settlement Agreement is vastly improved relative to the design in the
10 current tariff.

11 In particular, the Settlement Agreement's treatment of Schedule E-32
12 strikes a proper balance between demand and energy charges. In a system such as
13 APS', in which new distribution infrastructure and new generation resources must
14 be added to meet a growing system peak, it is critical on grounds of both fairness
15 and efficiency to levy a demand charge that sufficiently places cost responsibility
16 on those customers responsible for the costs incurred in meeting the system peak.
17 The demand charge performs this function. Failure to properly weight demand
18 cost responsibility would cause an improper subsidy among the customers within
19 the E-32 rate schedule, which would result in higher-load-factor customers
20 subsidizing the peak-related costs caused by lower-load-factor customers. The
21 Settlement Agreement achieves a proper balancing of costs through the setting of
22 the demand and energy charges.

1 In addition, the Settlement Agreement provides for an optional time-of-use
2 rate that is open to all E-32 customers, increasing the pricing options available to
3 customers on this rate schedule.

4 **Q. Are there specific aspects of the E-35 rate design that you wish to point out?**

5 A. Yes. In addition to the general design issues discussed above, Paragraph
6 118 of the Settlement Agreement retains the existing 11:00 AM to 9:00 PM on-
7 peak time periods in the current tariff. In its initial Application, APS had proposed
8 to modify the definition of this time period, by starting the on-peak period two
9 hours earlier each day. The proposed change would have caused unintended
10 problems for E-35 customers that have adapted their business operations to meet
11 the terms of the existing definitions in the tariff. The Settlement Agreement averts
12 this problem.

13 **Q. In your opinion, is the Settlement Agreement's treatment of the specific rate
14 designs of Schedules E-32, E-34, and E-35 just and reasonable?**

15 A. Yes. The rates in Appendix J of the Settlement Agreement reflect a proper
16 treatment of the relationship between demand and energy charges, the designation
17 of rate blocks, the differentiation of rates by voltage, and the demarcation of
18 unbundled components, among other things. Every component of the General
19 Service rates in Appendix J is an integral part of the Settlement Agreement and
20 should be adopted by the Commission.

1 **Demand-Side Management**

2 **Q. What aspects of the Settlement Agreement's treatment of DSM do you wish**
3 **to address?**

4 A. I have a few limited comments on the DSM provisions in the Settlement
5 Agreement. Specifically, I will address the rate design of the DSM adjustment
6 mechanism for General Service customers, and I will comment on the provision
7 in the Settlement Agreement that provides a process for evaluating the merits of
8 allowing large customers to self-direct any DSM investments.

9 **Q. How does the Settlement Agreement treat rate design for the DSM**
10 **adjustment mechanism, as it applies to General Service customers?**

11 A. Paragraph 43 establishes a DSM adjustment mechanism for any approved
12 DSM expenditures in excess of the \$10 million base rate DSM allowance.
13 General Service customers that are demand-billed will pay a per-kW charge
14 instead of a per kWh charge. This allocation *within* the General Service class does
15 not impact the allocation *across* classes, which is performed on a per-kWh basis.

16 **Q. In your opinion, what is the rationale for providing a process to evaluate the**
17 **merits of allowing large customers to self-direct any DSM investments?**

18 A. If the DSM adjustment mechanism grows to a significant size, larger
19 customers may be required to contribute tens of thousands of dollars to this
20 program. In my opinion, it is far more equitable for these customers – who are
21 primarily businesses and public sector entities – to be able first to direct the funds
22 they contribute to their own DSM opportunities, rather than have their
23 contributions used to subsidize other businesses and public sector customers.

1 Paragraph 55 provides a forum for evaluating the merit of self-direction, which I
2 believe is an important component of any mandatory DSM funding.

3
4 **Direct access service**

5 **Q. What does the Settlement Agreement state with respect to direct access**
6 **service?**

7 A. The Settlement Agreement makes no changes to direct access service.
8 Paragraph 82 of the Agreement states that changes to retail access shall be
9 addressed through the Electric Competition Advisory Group or other similar
10 process.

11 **Q. Do any of the provisions of the Settlement Agreement have implications for**
12 **direct access service?**

13 A. Yes. There are a number of provisions of the Settlement Agreement that
14 have implications for direct access service. To the best of my knowledge, all are
15 salutary.

16 **Q. Please elaborate.**

17 A. As I discussed above, the rates incorporated in the Settlement Agreement
18 include unbundled rate components. This feature will make the process of
19 evaluating direct access opportunities more transparent for customers who wish to
20 do so. In addition, in moving to the stipulated revenue requirement, the generation
21 component for Schedules E-32, E-34, and E-35 is moved first to cost, in order not
22 to distort the economics of shopping.

1 Further, as part of moving the West Phoenix PWEC assets into rate base,
2 Paragraph 15 provides that these units shall be deemed "local generation" as that
3 term is used in the AISA protocol or any successor FERC-approved protocol.

4 During must-run conditions, generation from the West Phoenix facility shall be
5 available at FERC-approved cost-of-service prices to electric service providers
6 serving direct access load in the Phoenix load pocket. This provision ensures that
7 electric service providers serving direct access customers in the Phoenix load
8 pocket can have access to this local generation without being subject to pricing
9 that is distorted by exercise of market power.

10 Finally, as I discussed above, APS has agreed to forego any present or
11 future stranded cost claims on the PWEC assets coming into rate base. This
12 provision prevents direct access service from being undercut by a future stranded
13 cost claim resulting from the Settlement Agreement's inclusion of these assets in
14 rate base.

15 **Q. In stipulating to this provision, are AECC, Phelps Dodge, FEA, or Kroger**
16 **acknowledging that any future APS stranded cost claims on other assets are**
17 **valid?**

18 **A.** Absolutely not. This provision of the Settlement Agreement simply
19 removes the PWEC assets from the realm of any future debate on this topic.

20
21 **Conclusion**

22 **Q. Do you have any summary conclusions you would like to offer to the**
23 **Commission?**

1 A. Yes. The Settlement Agreement is a comprehensive stipulation that took
2 months to craft. It represents a compromise among a diverse set of Parties who
3 were able to reach agreement through good-faith negotiations. The Settlement
4 Agreement, in its complete form, produces an outcome that I believe is just,
5 reasonable, and in the public interest. I strongly recommend that the Commission
6 approve it in the form it has been submitted.

7 **Q. Does this conclude your direct testimony on this matter?**

8 A. Yes, it does.